STATE OF WASHINGTON

DEPARTMENT OF LABOR AND INDUSTRIES

INDUSTRIAL INSURANCE FUND

FINANCIAL INFORMATION
(UNAUDITED)

For the following funds:
608 - Accident Fund
609 - Medical Aid Fund
610 - Accident Reserve Fund

As of June 30, 2002

Prepared by: Insurance Services Division

10/14/02

State of Washington
Department of Labor and Industries
Industrial Insurance Fund

Management's Discussion and
Analysis of Results of Operations
and Financial Condition

Cash Flow from Operations

The Industrial Insurance Fund (the Fund) administers the Workers' Compensation Insurance program in the state of Washington. Workers' Compensation benefits are paid for lost wages during disability, permanent partial and total disability, vocational rehabilitation and medical costs incurred in conjunction with the injury. Benefits are funded by premiums paid by employers and employees who are not self-insured and earnings of the Fund's investment portfolio.

Premiums collected during the fiscal year ending June 30, 2002 were $840 million, declining $57 million (6.3%) compared to the previous fiscal year. Declining exposures continue to drive the collected premium downward.

Benefits paid during fiscal year 2002 were $1.02 billion. Annual benefit payments grew 1.8%. The ratio of expenses paid to benefits paid was constant over the year at 18.4%.

Cash flow from investment income (primarily interest) was $123 million for the quarter and $514 million for the fiscal year. This is a 5.0% annual drop, due to a generally shrinking asset base and lower market yields.

Financial Condition

Total assets decreased by $270 million in the quarter. Bond values declined by $97 million in the quarter, largely as a result of loss of investment grade status. Equity holdings declined with the market by $164 million in the quarter. Total assets declined by $249 million in the fiscal year to end at $8.46 billion. The contingency reserve dropped $323 million in the quarter and $644 million for the year to end at $582 million. The contingency reserve is distributed by fund as follows:

	Contingency Reserve			
Funds	Target % of Liabilities	Current	Target	"Excess"
608	10%	$179 M	$337 M	-
610	1%	$0 M	$17 M	-
Accident*	7.1%	$179 M	$354 M	-$175 M
Medical Aid	15%	$403 M	$425 M	-$22M
TOTAL	10%	$582 M	$777 M	-$197 M

Annual net earned premiums declined 7.7% due to declining exposures. Net annual retrospective return premiums were $96.6 million for the fiscal year.

Reserves

Total benefit reserves increased by $102 million in the quarter and $378 million in the fiscal year. The fiscal year rates of increase were 5.9% for the Accident Fund, 2.7% for the Medical Aid Fund and 9.4% for the Pension Fund. Together the Accident and Pension fund reserves grew by $313 million, 7.1% over the fiscal year.

Accident Fund reserves tested deficient by $25 million in the quarter. Timeloss was adverse by $60 million and TPD was beneficial by $34 million.

The Medical Aid Fund had beneficial loss reserve development of $66 million during the quarter, $20 million from Vocational Rehab reserves.

The Claim Administration reserves increased $0.7 million overall this quarter and $45 million in the fiscal year.

Reinsurance

The Fund carried catastrophic reinsurance of $375 million excess of the first $25 million of loss in three equal $125 million layers through September 30, 2001. The October 1, 2001 renewal coverages were diminished as reinsurers withdrew availability:

Layer	Ceded Loss		Retained
$M	$Million (max)	Percent	Loss
0-25	0	0%	100%
25-150	60.25	48%	52%
150-275	26.25	21%	79%
275-400	10.25	8%	92%
TOTAL	96.75	26%	74%

The fund retains a proportional share of the premium by layer.

Liquidity and Capital Resources

The Fund's operation requires liquidity sufficient to meet both short-term and long-term requirements. Short-term liquidity requirements come from three basic elements. First, workers' compensation claims are subject to some variation, usually inflationary. Second, benefit payment and investment operations are sensitive to variations in premium adequacy. Finally, dividends and retrospective returns require an increased degree of liquidity.

The Fund has generally met its operating requirements by maintaining appropriate levels of liquidity in its investment portfolio and through utilization of positive cash flow. This has allowed the Fund to minimize trading activity, maintain a stable investment portfolio, and provide a sound basis for adequate Reserves for Estimated Future Benefits.

The Washington State Investment Board and the Washington State Treasurer manage the Fund's investment portfolio. The portfolio is managed to balance cash flow, timing and reinvestment risks, and then maximize current income while preserving capital. The Fund has the financial capability to hold its fixed-income portfolio to maturity, and to match projected cash inflows from premiums and investment income from this portfolio with projected cash outflows for payment of benefits. All currently held fixed-income securities were rated Investment Grade when purchased. All foreign fixed-income securities are dollar-denominated.

All equity holdings are in the form of index funds. The Barclay-Wilshire 5000 equity fund (BGI) was designed to match the Wilshire 5000. The Wilshire 5000 index declined 12.9% in the last quarter, 17.8% on the fiscal year. The EAFE index, tracking the performance of the International Index Fund, was down 2.8% in the quarter and 11% on the year.

Equity securities were distributed by fund as follows:

	6/30/2002
Barclay-Wilshire 5000 Index Fund	84%
International Index Fund	16%
	100%

State of Washington
Department of Labor and Industries
Industrial Insurance Fund

Management's Discussion, continued...

The Fund realized losses of $27 million on sales of fixed income investments in the fiscal year. Losses of another $73 million were recognized as a number of bonds below investment grade were deemed not expected to recover. Equity securities are recorded at market value; investments in fixed-income securities are usually recorded at amortized cost. Distressed securities are carried at the lesser of amortized cost or market value. The bonds dropping below investment grade in the quarter were mostly communication issues, WorldCom the most obvious.

The market value of fixed-income investments increases as interest rates decline. Fixed maturities (bonds) are usually held to maturity so that differences between market value and carrying value will not significantly influence management's investment decisions or future investment income or yields.

At June 30, 2002, the investment portfolio consisted of the following (in millions):

Asset Class	Carrying Value		Market Value		Diff
Corporate fixed income securities	3,086	39%	3,163	38%	(77)
Mortgages and mortgage backed securities	1,542	19%	1,643	19%	(101)
Common and preferred stocks (at market)	1,313	16%	1,313	16%	-
U.S. Treasury securities	1,226	15%	1,383	16%	(157)
Debt securities issued by foreign governments	672	8%	693	8%	(21)
Asset backed securities	145	2%	156	2%	(11)
Money market	106	1%	106	1%	-
Total Securities	8,090	100%	8,457	100%	(367)

Commitments and Contingencies

Effective July 1, 1992, the Washington State Legislature required the Fund to participate in an assigned risk pool providing workers compensation coverage under the United States Longshore and Harbor Workers' Act. The Fund is obligated to participate 50% in the operating results of the assigned risk pool. This participation is scheduled to continue; state legislation passed in 1997, which extended the Fund participation indefinitely. No loss was recorded through March 31, 2002.

STATE OF WASHINGTON INDUSTRIAL INSURANCE FUND
SUMMARY of FINANCIAL CONDITION
(000's) omitted
UNAUDITED

Assets

	6/30/02	3/31/02	6/30/01
Cash and Investments:			
Bonds, at Amortized Cost	$6,777,424	$6,874,818	$7,135,293
Stocks, at Market Value (Cost $1,429,214; $1,456,186; $1,130,850)	$1,312,528	$1,476,038	$1,171,896
Net Unsettled Trades	$336	$8,265	($5)
Cash	($15,650)	$10,523	($1,460)
Total Cash and Investments	$8,074,638	$8,369,644	$8,305,724
Other Assets:			
Premiums Receivable, Net	$217,280	$201,361	$233,788
Interest Receivable	$98,834	$101,085	$107,885
Land, Buildings and Equipment, Net	$59,254	$58,996	$59,610
Other Assets	$11,013	$29	$2,896
Total Other Assets	$386,381	$361,471	$404,179
Total Assets	$8,461,019	$8,731,115	$8,709,903

Liabilities and Contingency Reserve

Liabilities

	6/30/02	3/31/02	6/30/01
Estimated Future Benefits:			
Accident Fund	$3,011,406	$2,973,954	$2,843,495
Medical Aid Fund	$2,512,856	$2,510,653	$2,447,619
Pension Reserve Fund	$1,693,227	$1,630,423	$1,548,046
Total Estimated Future Benefits	$7,217,489	$7,115,030	$6,839,160
Other Liabilities:			
Claims Administration	$468,887	$468,153	$423,953
Retro Rating Adjustments	$102,793	$156,736	$119,977
General Obligation Bonds Payable	$48,076	$48,078	$50,475
Other Accrued Liabilities	$39,999	$36,663	$48,545
Deferred Revenue	$1,992	$2,036	$2,006
Total Other Liabilities	$661,747	$711,666	$644,956
Total Liabilities	$7,879,236	$7,826,696	$7,484,116
Contingency Reserve	$581,783	$904,419	$1,225,787
Total Liabilities and Contingency Reserve	$8,461,019	$8,731,115	$8,709,903

This information is from Washington State's Accounting and Financial Reporting System.

STATE OF WASHINGTON INDUSTRIAL INSURANCE FUND
SUMMARY of OPERATIONS and CONTINGENCY RESERVE
(in thousands of dollars)
For 3 months and 12 months ending June 30, 2002,
and 12 months ending June 30,2001
UNAUDITED

Revenues	**3 months ended 6/30/02**	Percent of Net Premium	**YEAR ended 6/30/02**	Percent of Net Premium	**YEAR ended 6/30/01**	Percent of Net Premium
Premiums Earned:						
Net Standard Premiums	$206,652	111%	$823,087	113%	$877,061	111%
Retrospective Rating Adjustments	($21,199)	-11%	($96,571)	-13%	($89,811)	-11%
Net Premiums Earned	$185,453	100%	$726,516	100%	$787,250	100%
Net Investment Income	$119,465	64%	$492,928	68%	$512,919	65%
Net Realized Gains (Losses) Fixed Income	($83,473)	-45%	($98,385)	-14%	$36,694	5%
Net Gains (Losses) Equities	($163,937)	-88%	($185,042)	-25%	($223,836)	-28%
Self Insured Pension Contributions	$24,780	13%	$39,368	5%	$49,635	6%
Other Income (Expense)	($4,710)	-3%	$0	0%	$4,710	1%
Total Revenues	$77,578	42%	$975,385	134%	$1,167,372	148%
Expenses						
Benefits Incurred:						
Accident Fund	$154,419	83%	$617,329	85%	$518,835	66%
Medical Aid Fund	$112,452	61%	$467,731	64%	$380,182	48%
Pension Reserve Fund	$105,789	57%	$312,261	43%	$313,521	40%
Total Benefits Incurred	$372,660	201%	$1,397,321	192%	$1,212,538	154%
Administrative Expenses:						
Claims Administration	$24,984	13%	$141,009	19%	$92,394	12%
Underwriting	$7,557	4%	$28,275	4%	$27,491	3%
General Insurance Expense	$6,292	3%	$22,173	3%	$21,465	3%
Other Administrative Expenses	$18,554	10%	$37,702	5%	$58,493	7%
Total Administrative Expenses	$57,387	31%	$229,159	32%	$199,843	25%
Total Expenses	$430,047	232%	$1,626,480	224%	$1,412,381	179%
Net Income	($352,469)	-190%	($651,095)	-90%	($245,009)	-31%
Change in Non-Admitted Assets	$29,834		$7,091		$19,129	
Change in Contingency Reserves	($322,635)		($644,004)		($225,880)	
Contingency Reserve, beginning of period	$904,419		$1,225,787		$1,451,667	
Contingency Reserve, end of period	$581,783		$581,783		$1,225,787	

This information is from Washington State's Accounting and Financial Reporting System.

STATE OF WASHINGTON
INDUSTRIAL INSURANCE FUND
CASH FLOW SUMMARY
(in thousands of dollars)
For the 3 months and 12 months ended June 30, 2002
and
12 months ended June 30, 2001
UNAUDITED

	3 months ended 6/30/02	Percent of Net Premium	**12 months ended 6/30/02**	Percent of Net Premium	**12 months ended 6/30/01**	Percent of Net Premium
Standard Premiums Collected	$190,731	154%	$839,594	111%	$896,407	108%
Self Insured Pension Contributions Collected	$7,863	6%	$28,727	4%	$39,117	5%
Retrospective Rating Adjustments	($75,142)	-61%	($113,755)	-15%	($102,908)	-12%
Net Premiums Collected	$123,452	100%	$754,566	100%	$832,616	100%
Other Income (Expense)	$3,502	3%	$12,556	2%	($170,831) *	-21%
Fund Transfers In (Out)	$2,366	2%	$10,138	1%	$9,638	1%
Cash Flow In	$129,320	105%	$777,260	103%	$671,423	81%
Benefits Paid	$270,202	219%	$1,018,993	135%	$1,000,681	120%
Claims Administration Expense	$24,249	20%	$96,074	13%	$95,839	12%
Premium Administration Expense	$6,543	5%	$26,031	3%	$26,351	3%
General Insurance Expense	$5,476	4%	$20,414	3%	$20,575	2%
Other Administrative Expense	$11,283	9%	$44,809	6%	$41,449	5%
Cash Flow Out	$317,753	257%	$1,206,321	160%	$1,184,895	142%
Operating Cash Flow	($188,433)	-153%	($429,061)	-57%	($513,472)	-62%
Net Investment Income	$123,001	100%	$513,711	68%	$540,734	65%
Temp Fund (Purchases)/Sales	$0	0%	$0	0%	$0	0%
(Purchases)/Sales	$39,259	32%	($98,840)	-13%	($26,372)	-3%
Fixed Asset Activity, Net	$0	0%	$0	0%	($1,395)	0%
Net Cash Flow	($26,173)	-21%	($14,190)	-2%	($505)	0%
Beginning Cash	$10,523		($1,460)		($955)	
Ending Cash	($15,650)		($15,650)		($1,460)	

* Includes cash dividends of $195M.

The source of this financial information is Washington State's Accounting and Financial Reporting System.

State of Washington
Industrial Insurance Fund

Notes to Financial Information

Note A - Summary of Significant Accounting Policies

The State of Washington prepares a Comprehensive Annual Financial Report (CAFR), which includes all funds and account groups of the State. The CAFR is prepared in accordance with generally accepted accounting principles (GAAP). The financial activities of the Labor and Industries workers' compensation programs are included in the CAFR.

The accompanying financial information uses "statutory" accounting principles, as would be required of a casualty insurance enterprise when reporting its financial condition to insurance regulators.

Under statutory accounting principles, certain assets (principally receivables which are greater than ninety days past due and office furniture and equipment) are charged against the contingency reserve. Under GAAP, such assets would be recorded on the balance sheet as assets, less valuation allowances or accumulated depreciation.

Bonds are stated at cost, adjusted for amortization of premiums and accretion of discounts, which are recognized as adjustments to investment income. Under GAAP, some or all of the fixed income securities would be stated at market value. Gains or losses on disposition are based on net proceeds and the adjusted carrying amount of the securities sold, using the specific identification method. Equity securities are stated at market value. Changes in unrealized appreciation or depreciation on equity securities are reflected separately in the income statement.

The Supplemental Pension and Second Injury Funds (See Note C) were not included in these statements because the primary purpose of these statements is to present the financial condition and results of operations of those funds required to maintain actuarial solvency as a basis for premium rates.

Note B - Description of the Industrial Insurance Fund

The State of Washington, through Title 51 RCW, requires employers to secure payment of benefits for job-related injuries and diseases either by paying insurance premiums to the Workers' Compensation Fund or by self-insuring. Direct private insurance is not authorized, although self-insurers are permitted to reinsure up to 80 percent of their obligations.

State of Washington
Industrial Insurance Fund

Notes to Financial Information

The statutes provide five benefit funds to make compensation payments to injured employees for various losses. The Accident, Medical Aid, and Pension Reserve Benefit Funds are required to be self-sustaining by insurance premiums. These financial statements report on the financial condition and results of operations of these funds.

The Accident Fund pays compensation directly to injured employees for lost wages during temporary disability, for permanent partial disability awards, and awards pensions to survivors of fatally injured workers and to workers adjudged to be permanently and totally disabled. Claim liabilities are discounted to their present value, as reported in these financial statements, based upon a 4.0% interest rate assumption. Revenues for this fund are provided by employer-paid premiums, calculated on the basis of hours worked. Employers may elect to be retrospectively rated. All retrospective premium adjustments are financed entirely through the Accident Fund. The adjustment calculation considers both Accident Fund and Medical Aid Fund experience and premiums together, however, no retrospective adjustments are made through the Medical Aid Fund.

The Medical Aid Fund pays for the cost of medical and vocational rehabilitation service to injured workers. Employers are allowed to withhold half of the medical aid premium from employees' wages. Medical reserves are discounted to their present value, as reported in these financial statements, based upon a 4.0% interest rate assumption. Revenues for this fund are provided by equal contributions from employers and employees.

The Pension Reserve Fund pays benefits to all permanently disabled pensioners including disabled employees of self-insured employers. These reserves are discounted based upon a 6.5% interest rate assumption. Funding for these pensions is provided by transfers from the Accident Fund and from self-insurers.

The Accident, Medical Aid and Pension Reserve Funds are required to be maintained on an actuarially solvent basis, except that a cash flow basis is authorized for the components of the Pension Reserve fund when self-insured employers guarantee related benefits, with a surety bond.

The Agency's actuaries compute benefit and claim administration expense liabilities. Independent consulting actuaries review these liabilities at the end of the fiscal year. The liabilities are estimated future claim and claim administration expense payments for injuries occurring on or before the balance sheet date on a discounted basis. Future premium income is not offset against claim liabilities, as the claims liabilities arise from coverage periods for which premiums have, in general, already been fully earned. The obligation to pay claim and claim administration expense liabilities is not contingent upon any future premium for future coverage periods.

Note C - Other Related Funds

The Second Injury Fund is used to pay pension costs on claims where permanent total disability is at least partially caused by a prior injury. It is funded by amounts received from the Accident and Medical Aid Funds for state fund claims, and by self-insured assessments for self-insured claims. An allowance for future second injury benefit payments is contained within the Accident Fund and Medical Aid Fund claim reserves for State Fund claims. Therefore, this fund does not carry any reserves. This fund's operations are not directly accounted for in these financial statements, but second injury claims, which it services, are accounted for through the Accident and Medical Aid Funds.

The Supplemental Pension Fund provides for supplemental cost-of-living adjustments to injured employees receiving disability payments. However, the enabling statute requires this fund to operate on a current payment basis and is subject to legislative cancellation. No assets are allowed to accumulate for the future servicing of current claims.

Cost-of-living increases are based on the increase in the state average wage during the preceding calendar year and are granted in July. This fund is financed through assessments to self-insurers and State employers; half of the assessment may be deducted from employees' wages. Income, expense, assets, or future claim liabilities related to Supplemental Pension or Second Injury Funds are not included in the attached financial statements.

The Second Injury Fund and the Supplemental Pension Fund are included in the CAFR. Because these funds are not required to maintain actuarial solvency, as the Accident, Medical Aid, and Pension Funds do, they are not included in this financial information.

Note D - Premiums Receivable, Net

All employers in the State of Washington subject to Title 51 of RCW are required to be covered by the Industrial Insurance Fund and pay policy premiums for workers' compensation insurance, except for certain qualifying employers electing to self-insure. Premiums are normally based on individual employers' reported payroll hours and insurance rates based on each employer's risk classification(s) and past experience. In addition to its regular premium plans, the Fund offers a retrospective premium rating plan under which premiums are adjusted annually for up to four years following the plan year based on employers' loss experience. Adjustments to the original premiums are paid to or collected from the associations and employers approximately ten months after the end of each plan year.

Employer premiums are due 30 days following the calendar quarter covered. An allowance for uncollectible premiums is established when the account becomes delinquent.

Note E - Reinsurance

The Agency maintains reinsurance agreements, which provide for recovery of ultimate benefit costs on a catastrophic occurrence basis. Protection ending 9/30/2001 was for $375 million in excess of $25 million. Renewing coverage has been limited by reinsurer capacity shortages to:

First Layer - $60,250,000 pro rata $125,000,000
Second Layer - $26,250,000 pro rata $125,000,000 and
Third Layer - $10,250,000 pro rata $125,000,000.

The Agency would be liable for the proportional retained loss by layer and to the extent reinsuring companies are unable to meet their treaty obligations. Reinsurance premiums, commissions, expense reimbursements and reserves related to reinsurance ceded are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts. Premiums ceded to other companies have been reported as a reduction of premium income.

Note F - Estimated Future Benefits

Reserves for unpaid benefits and claims administration expenses in the Accident Fund and Medical Aid Fund are provided based primarily on ratios of paid to date losses for older accident periods. For more recent accident periods, a selection of several common actuarial techniques is used. These estimates are continually under review and, as changes to the liabilities become necessary, such adjustments are reflected in income currently. The estimates are calculated and presented net of all recoveries. Recoveries include overpayments and successful subrogation against third parties. Recoveries may be in the form of cash or deduction against continuing benefits.

The liability for benefits for the Pension Reserve Fund is determined from individual claims transferred to this fund. Such liabilities are necessarily based on estimates and, while management believes that the amount is adequate, the ultimate liability may be in excess of or less than the amounts provided.